

VZCZCXRO2582
PP RUEHAG RUEHDF RUEHIK RUEHLZ
DE RUEHRO #1005/01 0940436
ZNR UUUUU ZZH
P 040436Z APR 06
FM AMEMBASSY ROME
TO RUEHC/SECSTATE WASHDC PRIORITY 4291
INFO RUCNMEU/EU INTEREST COLLECTIVE PRIORITY
RUCNMEM/EU MEMBER STATES COLLECTIVE PRIORITY
RUEHSI/AMEMBASSY TBILISI PRIORITY 0197
RUEHKB/AMEMBASSY BAKU PRIORITY 0076
RUEHFL/AMCONSUL FLORENCE PRIORITY 1276
RUEHMIL/AMCONSUL MILAN PRIORITY 6875
RUEHNP/AMCONSUL NAPLES PRIORITY 1341

UNCLAS SECTION 01 OF 04 ROME 001005

SIPDIS

SIPDIS

E.O. 12958: N/A

TAGS: [ECON](#) [ENRG](#) [EPET](#) [RU](#) [IR](#) [QA](#) [IT](#)

SUBJECT: EUR DAS BRYZA DISCUSSES CASPIAN BASIN NATURAL GAS
POTENTIAL WITH ITALY

REF: A. ROME 933

[1](#)B. ROME 834

ROME 00001005 001.4 OF 004

[1](#)1. (U) Summary: In March 17 meetings, GOI officials in the Ministries of Foreign Affairs, Productive Activities, and the Prime Minister's office concurred with EUR DAS Matthew Bryza's assessment of the risk to Italian and European energy security of Gazprom's dominance of natural gas shipments to Europe and Italy. GOI officials proposed a conference to examine the feasibility of a Turkey-Greece-Italy inter-connector pipeline, agreed that NATO should undertake a discussion of the "geo-economic" elements of the Europe-Russia energy relationship, and outlined the GOI vision of Italy as a Southern European natural gas hub. Officials at ENI, Italy's largest oil and gas company, lamented the lack of coordination between government and the private sector on increasing Italy's sources of energy, and pointed out that new EU Member States' privatization policies may aid Gazprom's entry into the European market. ENI officials, also commenting on the state of Iran's natural gas industry, concluded that Iran has lost ground to Qatar and that in the immediate future, most Iranian gas production will be consumed domestically. End Summary.

Introduction

[1](#)2. (U) EUR DAS Matthew Bryza met with GOI and ENI officials March 17 to discuss energy security and access to Caspian Basin natural gas. In separate meetings, Bryza discussed energy security and regional stability issues with MFA Director General (DG) for Multilateral Economic Affairs, Giandomenico Magliano; Ministry of Productive Activities (MPA) DG for Energy Sergio Garribba; the Energy Authority; and ENI Senior Vice President for Corporate Strategies Leonardo Maugeri. DAS Bryza's meetings with Deputy Diplomatic Advisor to the Prime Minister Francesco Talo and MFA DG for Multilateral Political Affairs Giulio Terzi, which did not cover energy issues, were reported in Ref A.

Agreement on Risks of Gazprom's Dominance

[1](#)3. (U) The Prime Minister's office, MFA, and ENI all agreed with Bryza's assessment that Gazprom's dominance of the European natural gas markets is a problem and that Gazprom needs to be channeled towards market behavior. Although Garribba, the GOI's leading expert on energy, previously

viewed energy security as a matter of increasing the routes through which Italy receives Russian gas (reported Ref B), he and other GOI officials with whom DAS Bryza met were receptive to introducing new sources of gas, such as the Caspian Basin, into the Italian and European markets.

14. (U) ENI's Maugeri expressed frustration at ENI's difficulties with Gazprom. He noted that Gazprom was the only buyer for natural gas ENI produced in gas fields in Kazakhstan. This dynamic put ENI in a weak negotiating position. Maugeri believes Gazprom and the GOR are trying to restore Russian prestige following a strategy first outlined by Russian President Putin in an academic essay published in the 1990,s.

15. (U) Garribba, Magliano, Maugeri, and Talo all agreed that Gazprom is conducting business in a non-transparent way. Further, that Gazprom is using its dominance of natural gas supplies and transmission infrastructure to realize huge profits, and that its management is focused on stifling competition, not on maximizing productivity. Magliano and Garribba agreed with DAS Bryza that introducing Central Asian gas into the European market using non Gazprom-owned pipelines would force market-based pricing onto the natural gas markets, and lead Gazprom to react by streamlining its operations and introducing more transparency to preserve its market dominance.

16. (U) Magliano proposed that NATO be used as a forum for discussion of the political aspects of energy security. He stressed that Russia "is a partner" for Europe and that the GOR should be included in these discussions. (Note: In doing so, he contradicted his subordinate, Gianni Manfredi, who had told Bryza in NATO meetings the previous day that the energy security issue should be kept out of NATO. End note.) Magliano also proposed that the International Energy Agency (IEA) be "staffed up" to examine the economic aspects of

ROME 00001005 002.2 OF 004

energy security, with an eye on implementing the G8's Gleneagles agreement on energy and global climate change. "Energy savings equal energy security," he said.

17. (SBU) Bryza told Talo and Terzi that Russia and Gazprom had used price and supply fluctuations to manipulate Russia's neighbors, particularly Georgia and Ukraine. The United States is encouraging the EU to help support Ukraine's efforts to take a second look at non-transparent energy deals to exclude shady middlemen. Noting that renegotiating the Ukraine-Gazprom agreements could create another short-term energy crisis for Europe, DAS Bryza said the USG hopes the EU will accept a short-term shock in exchange for long-term stability and transparency in Russian energy supplies.

Privatization Aids Gazprom.

18. (U) Garribba, Terzi, and Maugeri all noted that privatization of state-owned energy companies in new EU member states has the unintended consequence of aiding Gazprom's entry into European energy markets. All noted that Gazprom, because of its dominance of the European natural gas and oil markets, has the cash reserves to finance the acquisition of energy infrastructure throughout Eastern Europe. Maugeri said privatization has simply moved control of some Eastern European countries' energy infrastructures from the government to Gazprom and has not introduced competition to the market. "Market liberalization needs supply liberalization," according to Maugeri. Anything else is simply blind faith in "the animal spirits of capitalism." In a later meeting, Magliano echoed this statement by saying that more competition and less vertical integration are needed throughout the energy industry.

19. (U) Maugeri argued that the EU must slow privatization until other companies can compete with Gazprom to purchase

state-owned energy assets. He urged the USG and GOI to support slowing the process down, noting that if large oil companies like ENI make the case, their arguments are dismissed as an attempt to stifle competition. Maugeri argued that major oil company dominance is exaggerated. Citing an article he wrote for the March/April issue of Foreign Affairs, "Two Cheers for Expensive Oil," Maugeri stated that publicly-traded oil companies control less than eight percent of proven oil reserves, and less than twenty percent of proven gas reserves. The rest is controlled by privately-held or state-owned companies.

The Southern Corridor - The Best Route to Competition?

¶10. (U) All of DAS Bryza's GOI interlocutors agreed a "southern ring" of gas pipelines, including the Turkey-Greece-Italy inter-connector pipeline (TGI), could carry Caspian Basin natural gas to Europe via the Caucasus and Turkey. Further, that the introduction of non-Gazprom gas into the European market would force Gazprom to respond to market forces. Garribba views a southern ring of natural gas pipelines as complementing GOI plans to develop Italy's role as a "natural gas hub" for Europe.

¶11. (U) In contrast, Maugeri was dismissive of the TGI and the GOI natural gas hub strategy. According to Maugeri, Turkey signed large gas contracts in the 1990s in anticipation of increased natural gas demand. However, Turkish demand has not increased; and now the Turks need a way to re-export surplus gas imported from Central Asia. Maugeri argued that Italian energy companies should focus on increasing natural gas flows from Libya or building new LNG terminals. Maugeri dismissed the GOI vision of Italy as a natural gas hub as "not economically viable." (Comment: Maugeri's rhetoric may be motivated by a desire to minimize ENI's competition within Italy. ENI cannot invest in additional gas pipelines to Italy because Italian law places a 67 percent ceiling on ENI's contribution to the Italian natural gas system through 2010. ENI is already importing as much gas as it can under current laws. End comment.)

¶12. (U) In his meeting with Magliano, DAS Bryza noted that if the TGI and other pipelines are used to move Central Asian gas, investment sequencing is very important. Specifically, downstream investors must be assured that a pipeline will be in place to move the natural gas extracted from Central Asian gas fields; and investors in the pipeline will have to know

ROME 00001005 003.2 OF 004

that there will be gas to fill the pipelines. Magliano proposed a feasibility conference to bring upstream and downstream investors together with banks and financiers to discuss the feasibility of using TGI and other pipelines to connect Central Asia to Europe. Magliano proposed the conference be modeled on that held prior to the construction of the Baku-Tblisi-Ceyhan pipeline.

The GOI Vision: Italy as Europe's Natural Gas Hub

¶13. (U) Garribba noted that construction of a southern ring of gas pipelines will complement GOI plans to turn Italy into a southern European natural gas hub. As envisioned by the GOI, increasing the capacity of existing pipelines to North Africa, completing the TGI pipeline, and increasing the number of LNG re-gasification terminals in Italy will enable Italy to become a transit country for gas flowing to landlocked countries in Eastern Europe. Garribba noted that initially, the TGI would carry "Bluestream gas" owned by Gazprom, but that in the future the pipeline could carry Caspian Basin gas, including Iranian gas. Both Garribba and officials at the Energy Authority cited agreements signed between the GOI and other governments (Serbia, Romania, and Slovenia, for example) as signs GOI plans are moving forward.

¶14. (U) Both Garribba and Magliano emphasized the use of LNG terminals to increase Italy's sources of natural gas. Both see LNG terminals as more flexible than pipelines, which have fixed routes. ENI's Maugeri agreed, and said LNG terminals are more viable than additional pipelines.

¶15. (U) Officials at the Energy Authority, Italy's independent energy industry regulator, told DAS Bryza they will enact regulatory incentives to speed the construction of natural gas infrastructure. The Energy Authority's goal is to speed the completion of the TGI pipeline and the construction of LNG terminals. The Energy Authority is reaching out to other energy regulators in the Mediterranean Basin, including the Balkans, and will host regulatory workshops to harmonize regulations.

¶16. (U) Maugeri characterized the GOI "southern hub" plan as "not economically viable," and views it as an example of bad government decision making. He called plans to build a pipeline from Algeria to Sardinia "Mickey Mouse," and added construction "will never happen." According to Maugeri, the GOI is entering into agreements with other governments for pipelines that the private sector doesn't think are viable. He cited the agreement signed between the GOI and Serbia, Romania, and Slovenia as an example. (Comment: Maugeri's pessimism regarding these projects is likely caused by legal restrictions on the amount of gas that ENI can bring into the Italian market. Other Italian oil and gas companies, such as Edison, may not share Maugeri's view. End comment.)

ENI's Thoughts on Iran

¶17. (U) During his meeting with ENI officials, DAS Bryza asked about ENI's experience doing business in Iran. Using the construction of LNG terminals as an example, Maugeri stated "it's easier to do business in Iran than in Italy." Maugeri continued that he does not understand the USG policy of "isolating" Iran. Pointing out that in the 1930's Italy became the first country subjected to multilateral sanctions (by the League of Nations following Ethiopia's invasion), Maugeri said that sanctions don't work, and that in the case of Iran, they only unify the otherwise pro-western population behind President Ahmadinejad's anti-western regime.

¶18. (U) Continuing, he said Iran's natural gas industry has fallen behind Qatar's, and that Iran is unlikely to play a major role in international gas markets because of Iran's high domestic demand for natural gas: Iran uses eight billion cubic meters of natural gas a year domestically, including gas used for re-injection into oil fields. The South Pars gas field, in which ENI has a substantial investment, will not export for some time, according to Maugeri.

Comment

¶19. (U) Two themes emerged from DAS Bryza's conversations with GOI and ENI officials. First, the GOI shares the USG

ROME 00001005 004.2 OF 004

concern over Gazprom dominance of European gas supplies and wants to find ways to strengthen market forces and channel Gazprom towards more constructive, market-based behavior. Second, the disconnect between the GOI and ENI on how to diversify Italy's natural gas sources is a reminder that the private sector should be included in discussions on Europe's energy security. This is especially important since the GOI and EU expect the private sector to take the lead in developing the infrastructure necessary to lessen Europe's dependence on Russian oil. End comment.

¶20. (U) DAS Bryza did not clear this cable prior to his departure.
SPOGLI